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INTERNATIONAL COUNTERTRADE

Draft Legal Guide on International Countertrade Transactions

Report of the Secretary-General

Addendum

III. CONTRACTING APPROACH

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[Editorial note: The present draft chapter III is a revision of draft chapter bearing the same title and published in document A/CN.9/332/Add.2. The note in square brackets at the beginning of each paragraph indicates either the number under which the paragraph appeared in document A/CN.9/332/Add.2 or that the paragraph is new. The revisions of paragraphs that appeared in A/CN.9/332/Add.2 are underlined. An asterisk indicates the place where text has been deleted without adding new language. The whole section C is new.]

A. Structure of countertrade transaction [change of title]

1. [1] A preliminary question the parties have to address is the contract structure of the countertrade transaction. The parties may embody the obligations in regard to the shipments of goods in the two directions in one contract or they may embody those obligations into separate contracts. (For the discussion of the structure of the countertrade transaction and related insurance and financing considerations, see below, paragraphs 8 and 9, and section C.)

1. Single contract

2. [2] Under a single-contract approach the parties conclude one contract for the supply of goods in the two directions. Such a single contract may take the form of a barter contract (below, paragraphs 3 to 8) or the form of a merged contract (below, paragraphs 9 and 10). *

(a) Barter contract

3. [3] As noted in chapter II, "Scope and terminology of Legal Guide", paragraph 14, the Legal Guide uses the term barter in its strict legal sense to refer to a transaction involving an exchange of goods for goods, so that the supply of goods in one direction entirely or partly replaces the monetary payment for the supply of goods in the other direction. In a barter contract there is no need for a countertrade commitment since the parties agree at the outset of the transaction on all the contract terms for the shipments in the two directions. If the goods to be supplied in one direction are agreed to be of the same value as the goods to be supplied in the other direction, no monetary payment would be made. If the values are agreed to be different, the difference may be settled by monetary payment or by delivery of additional goods. The parties may or may not express the value of the goods in monetary terms. If they do so, the attachment of a price to the goods serves to compare the value of the deliveries. The parties may have to express the value of shipments in monetary terms due to customs or other administrative requirements.

[5]*

4. [7] Under a barter contract the quantity of goods to be shipped in one direction is often measured by the quantity of goods to be shipped in the other direction, rather than in terms of the market price for each shipment. The absence of a price in a barter contract or the use of prices that do not reflect the market prices might cause a difficulty when non-conforming goods

are delivered under a barter contract. If in such a case monetary compensation is regarded as the appropriate relief, the absence in the contract of a market price, or of any price at all, could lead to disagreement over the amount of the compensation due. The stipulation of a price other than the market price may also give rise to a difficulty in calculating customs duties when they are based on the market value of the goods.

5. [4] A factor that is often the main reason for using barter is that the use of barter eliminates or reduces the need for currency transfers. It may be noted, however, that the avoidance of currency transfers may also be achieved through the use of other contractual forms, namely, the parties may conclude separate sales contracts in each direction and agree to set off their payment claims under the contract (such setoff of mutual claims is discussed in chapter IX, "Payment", paragraphs to).

6. [6] A possible difficulty in a barter contract may be a risk that the party who has shipped goods does not receive the agreed goods from the other party. Payment against the presentation of shipping documents or the opening of a documentary letter of credit, devices used with other types of contracts to address an analogous risk in other types of contracts, cannot be used in barter since neither delivery is payable in money. One way of addressing this risk may be to agree that the deliveries are to be made simultaneously, to the extent it is practical for the parties to coordinate ther deliveries in this way. If simultaneous deliveries are agreed upon, the contract may clarify that, if one of the parties is not prepared to deliver on schedule, the other party would be entitled to withhold its delivery or to terminate the contract if the delay exceeds a specified period of time. The contract may also provide that the party who has breached its obligation to deliver at the agreed time must compensate the other party for loss arising from the delay or termination of the contract. The parties may address in the contract the question of which outlays or losses are to be compensated (e.g., warehousing costs, costs related to transportation, or a specified amount of overhead costs).

7. [6] The risk that the other party will not ship the agreed goods may also be overcome by providing for an independent guarantee to assure the party who has shipped of compensation in the event that the other party fails to ship (the use of guarantees for this purpose is discussed in chapter XII, "Security for performance", paragraphs __ and __). If a party finds it costly or is unable to provide such a guarantee, it may be agreed that that party is to deliver goods first. Insurance might be another possible means of limiting the risk that the risks that affect the party who has shipped first and thus "prepaid" the goods to be delivered subsequently by the other party (se below, paragraph 52).

8. [new paragraph] If the right of a party to receive goods in return for its delivery is not sufficiently secured, in particular by an independent bank guarantee, that party may find it difficult to obtain financing for the transaction from a bank or from a governmental credit agency. The entity providing financing may be reluctant to provide financing to the extent the profitability of the transaction and the ability of the party seeking credit to repay the credit depends on an unsecured obligation to deliver goods of the agreed quality.

(b) Merged contract

9. [8] The term "merged contract" is used to describe the case in which the two contracts, one for the delivery of goods in one direction and the other for the delivery of goods in the other direction, are merged into one comprehensive contract. The merged contract thus embodies all the terms covering the obligations of the parties to ship goods to each other and to pay for the goods they have received. The difference between a barter contract and a merged contract is that, under a barter contract, the delivery of goods in one direction constitutes payment for the delivery of goods in the other direction, while, under a merged contract, each delivery of goods gives rise to a monetary payment obligation. If the parties agree to set off their claims for payment under a merged contract, the difference between a merged contract and a barter contract * would be diminished in that in either case no transfer of money takes place or only the balance of the values of the deliveries in the two directions is transferred. As in barter, there is no need in a merged contract for a countertrade commitment since the deliveries to be made in the two directions are covered by definite contract terms.

10. [9] It appears that many legal systems are likely to give weight to a merger of the mutual obligations in determining the degree of interdependence between contract obligations for the deliveries of goods in the two directions. * Unless the parties provide in the contract that certain obligations regarding delivery in one direction are to be performed irrespective of non-performance of an obligation regarding delivery in the other direction, the mutual obligations are likely to be considered interdependent. The consequence of such interdependence would be that non-performance of an obligation such as non-delivery, refusal to take delivery, or non-payment relating to a shipment in one direction might be invoked as a reason for suspending or refusing performance in the other direction. Furthermore, termination of an obligation in one direction, whether or not a party is responsible for the termination, may be interpreted as entitling a party to terminate an obligation in the other direction. (Such interdependence of obligations may affect the ability of a party to insure the payment claim arising from its delivery of goods and to obtain financing for the delivery, see below, paragraph 51). If the parties using a merged contract approach wish to keep the obligation to ship goods in one direction and the corresponding payment obligation independent from the obligations relating to the shipment in the other direction, they should use unambiguous language to that effect. A related discussion of possible interdependence between the export contract and the countertrade agreement is contained below in paragraphs 17 to 19. Further discussion on the question of interdependence of obligations is found in chapter XIII, "Failure to complete countertrade transaction", paragraphs to .

2. Separate supply contracts [change of title]

11. [10] When the parties use separate contracts for the shipments in the two directions, they would use one of the following approaches:

(a) the export contract and the countertrade agreement are concluded simultaneously and the counter-export contract is concluded subsequently;

(b) the countertrade agreement is concluded prior to the conclusion of any definite supply contracts;

(c) the separate supply contracts for the shipment in each direction and the countertrade agreement establishing a relationship between them are concluded simultaneously.

12. [11] The obligation to ship goods in a particular direction in a countertrade transaction may be fulfilled by two or more different contracts, which may involve different buyers and sellers. While such a situation affects the contractual structure of a given transaction, it does not affect the nature of the discussion in this chapter. Therefore, references in the singular to a supply contract, as well as to an export or counter-export contract, also cover the situation in which more than one contract is concluded for the shipment of goods in a particular direction.

(a) Export contract and countertrade agreement concluded simultaneously

13. [12] The parties often finalize a contract for the shipment in one direction (export contract) before they are able to reach agreement on the contract for the shipment in the other direction (counter-export contract). Parties using this contracting approach may face a broad range of issues specific to countertrade. In order to ensure conclusion of the counter-export contract, the parties conclude, simultaneously with the conclusion of the export contract, a countertrade agreement containing the commitment to conclude the counter-export contract. The primary purpose of the countertrade agreement in such cases is, in addition to stating the countertrade commitment, to outline the terms of the future contract and to establish procedures for concluding and carrying out supply contracts. Possible issues to be addressed in such a countertrade agreement are enumerated below in paragraphs 29 to 33.

14. [13] The contents of the countertrade agreement would be influenced by the degree to which the parties are able to define the terms of the future contract. It is advisable that the countertrade agreement be as definite as possible concerning the terms of the future contract, in particular regarding the type, quality, quantity and price of the countertrade goods, in order to increase the likelihood that the countertrade commitment will be fulfilled. To the extent that the parties are not in a position to settle the terms of the counter-export contract in the countertrade agreement, they are advised to establish guidelines within which the terms are to be agreed upon and to lay down procedures for negotiation (for the discussion on the definiteness of the countertrade commitment see chapter IV, paragraphs 38 to 60). In any case, it is advisable to settle in the countertrade agreement the time period within which the countertrade commitment should be fulfilled (see chapter IV, paragraphs 7 to 20).

15. [14] The content of the countertrade agreement would also be influenced by the degree of interest the parties have in the shipments in the two directions. In many cases the exporter is primarily interested in the conclusion of the export contract, and the countertrade commitment results primarily from a desire to secure the export contract. In other cases, the importer purchases goods from the exporter in order to enable the exporter to finance the counter-import. In yet other cases, each side is particularly

interested in obtaining the goods being offered by the other side. Because the interests of the parties vary in such a manner, the content of the countertrade agreement may vary from case to case with respect to issues such as sanctions for non-fulfilment of the countertrade commitment, payment mechanisms, procedures for concluding the future contract and for monitoring fulfilment of the countertrade commitment, and interdependence of obligations.

16. [15] The simultaneous conclusion of an export contract and a countertrade agreement is an approach frequently used in counter-purchase, buy-back or offset transactions. In the case of the counter-purchase transaction, the parties may not yet know what type of goods would be counter-exported. In the case of a buy-back, the parties may not be able to agree on such terms as price or quantity because of the long time period between the conclusion of the contract for the export of the production facility and the beginning of production of resultant products. In an offset transaction, the parties may not know what type of goods will be counter-exported or the identity of the counter-exporters.

17. [16] The use of this contracting approach raises the question whether to include the terms of the countertrade agreement in the export contract or to embody those terms in a separate instrument. The choice of the parties in this regard may have an effect on the degree to which the obligations stipulated in the export contract and the obligations set forth in the countertrade agreement are considered to be interdependent. When there is such interdependence, a delay in the fulfilment or non-fulfilment of the countertrade commitment may provide the importer with a justification for suspending payment of the amounts due under the export contract or for deducting corresponding damages from the payment due under the export contract. Similarly, the exporter may regard a delay in payment for the export contract as a ground for delaying fulfilment of the countertrade commitment. Furthermore, delayed payment under the counter-export contract might prompt the importer to delay payment under the export contract. (Such interdependence of obligations may affect the ability of the exporter to insure its payment claim under the export contract and to obtain financing; see below paragraphs 51 and 53.)

18. [17] If the export contract and the countertrade agreement are embodied in separate contractual instruments, it appears that many legal systems would consider the two sets of obligations to be independent, except to the extent specific contract provisions establish interdependence. In other legal systems the export contract and the countertrade agreement may, despite the use of separate instruments, be considered to be interdependent on the ground that the obligations of the parties embodied in the two instruments form part of a single transaction. When the parties wish to avoid interdependence of obligations between the export contract and the countertrade agreement, or when they wish to limit interdependence to particular obligations, it is advisable that they embody the export contract and the countertrade agreement in separate instruments. When, despite the use of separate instruments, it is uncertain whether the obligations under the export contract and the countertrade agreement would be considered independent, it is advisable that the independence of the two sets of obligations be clearly expressed in the countertrade agreement.

19. [18] The parties may wish to establish, by express contract clauses, an interrelationship between particular obligations arising out of the export contract and out of the countertrade agreement, while keeping other obligations independent. The parties may, for example, agree that * the termination of the export contract permits the exporter to terminate the countertrade agreement, and that non-fulfilment of the countertrade commitment by the counter-importer entitles the counter-exporter to deduct an agreed amount as liquidated damages or penalty from payments due under the export contract. Further discussion on the question of interdependence is found in chapter XIII, "Failure to complete countertrade transaction", paragraphs ___ to ___.

(b) Countertrade agreement concluded prior to conclusion of definite supply contracts

20. [19] The conclusion of a countertrade agreement may be the first step in the transaction prior to the conclusion of any definite supply contracts in either direction. The aim of the countertrade agreement in such a case is to express the commitment of the parties to conclude supply contracts in the two directions and to establish procedures for concluding and implementing those contracts.

21. [19] In order to achieve the envisaged level of shipments in the two directions, it is advisable that the countertrade agreement be as definite as possible concerning the terms of the contracts to be concluded in the two directions (see chapter IV, "Countertrade commitment", paragraphs 38 to 60). The parties may also wish to establish mechanisms for monitoring and recording the progress made in achieving the agreed upon level of trade (chapter IV, paragraphs 61 to 74) and to provide sanctions for a failure to fulfil the countertrade commitment (chapter XI, "Liquidated damages and penalty clauses" and chapter XII, "Security for performance"). The need for sanctions may be diminished if the parties agree that their countervailing claims for payment for the shipments in each direction will be set off rather than paid for individually (see chapter IX, "Payment", paragraphs ___ to___). Such a payment mechanism would provide an incentive to both parties to order goods from each other and thereby attain the level of trade envisaged in the countertrade agreement. The incentive is derived from the fact that a party who has shipped goods will be stimulated to order goods from the other party in order to be compensated for its own deliveries. Furthermore, the parties may wish to address in the countertrade agreement the question of independence of the contracts in the two directions (see chapter XIII, paragraphs ___). These and other issues that the parties may wish to address in a countertrade agreement entered into prior to the conclusion of any supply contract are set out below in paragraphs 29 to 39.

(c) Export contract, counter-export contract and countertrade agreement concluded simultaneously

22. [20] When the parties simultaneously conclude a contract for the supply of goods in one direction and another contract for the supply of goods in the other direction, and there is no indication in the contracts that there is a relationship between them, the contracts would appear on their face to be independent of one another even if one party or both parties regarded the conclusion of one contract as a condition for the conclusion of the other contract. When, however, the parties wish to give contractual effect to an

intention that the conclusion of one contract be conditioned upon the conclusion of the other, i.e., when they wish to structure the contracts in the two directions as a countertrade transaction, the parties should conclude a countertrade agreement expressing that relationship.

23. [21] This contracting approach raises a limited number of issues since it does not involve a countertrade commitment. The main issue in this contracting approach is the manner in which the obligations of the parties with respect to the shipments in the two directions are to be linked by provisions in the countertrade agreement. There is no need to deal in the countertrade agreement with various issues related to the fulfilment of the countertrade commitment (in particular the type, quality, quantity or price of the countertrade goods, time schedules of fulfilment of countertrade commitment, security of performance or liquidated damages or penalties supporting the countertrade commitment). The issues that the parties may wish to address in a countertrade agreement concluded simultaneously with the definite supply contracts in the two directions are set out below in paragraphs 40 to 42.

B. Contents of countertrade agreement

24. [new paragraph] Matters of particular importance for the structure and implementation for countertrade transactions are dealt with in the countertrade agreement. While the Legal Guide concentrates on issues to be addressed in the countertrade agreement, where necessary, reference is made in the Guide to drawing up a provision in a supply contract that is influenced by the fact that the contract is part of the countertrade transaction. The following subsections 1 and 2 provide an outline of a possible content of a countertrade agreement, depending upon whether or not the countertrade agreement includes a countertrade commitment.

25. [new paragraph] A countertrade agreement with a countertrade commitment is used when the parties envisage concluding in the future one or more counter-export contracts, or when the parties envisage concluding in the future supply contracts in the two directions (cases (a) and (b) referred to above in paragraph 11). A countertrade agreement without a countertrade commitment is used when the parties have entered, at the outset of the transaction, into the contracts for the supply of goods in the two directions and there is therefore no need for a countertrade commitment (case (c) referred to above in paragraph 11).

26. [new paragraph] The content of a countertrade agreement involving a countertrade commitment is usually more complex and gives rise to more negotiation and drafting difficulties than a countertrade agreement without a countertrade commitment. The reason for the complexity and difficulty is that usually the parties, at the time of agreeing that they will in the future conclude a supply contract, are usually not in a position to specify, with sufficient definiteness, all the terms of the future contract. Lack of definiteness may make it difficult for the parties to draw up a countertrade agreement that will provide a sufficient assurance that the negotiations for the conclusion of a supply contract, containing terms acceptable to both parties, will be successful. The question of the definiteness of the countertrade commitment is discussed in chapter IV, paragraphs 38 to 60.

27. [Based on para. 26 of draft chapter II, A/CN.9/332/Add.1] Some of the issues listed below and discussed in the following chapters of the Legal Guide are essential in establishing a countertrade transaction that involves a countertrade commitment. For example, the parties would have to choose a contracting approach, express their commitment to engage in reciprocal trade, specify the extent of the commitment and the time frame within which the commitment should be fulfilled.

28. [Based on para. 26 of draft chapter II, A/CN.9/332/Add.1] Solutions to certain other issues listed below and dealt with in the Legal Guide, while not necessarily essential, would help to ensure proper implementation of the transaction. The parties will have to judge whether and to what extent various contractual issues discussed in the Legal Guide are relevant to the circumstances of the given case. Generally, it is advisable to settle in the countertrade agreement issues that the parties consider relevant since national legislations are likely not to have rules on issues specific to countertrade.

1. Countertrade agreement with countertrade commitment

29. [22] Countertrade commitment. The essential feature of a countertrade commitment is a stipulation by which the parties undertake to * conclude one or more supply contracts in one or in the two directions. In order to add definiteness to the commitment and increase the likelihood of its fulfilment, parties often include in the countertrade agreement provisions concerning terms of the anticipated contract, sanctions for the failure to conclude the supply contract, and other provisions to ensure the proper carrying out of the countertrade transaction. Various aspects of the countertrade commitment are discussed in chapter IV.

30. [23] Type, quality and quantity of goods. In order for the countertrade commitment to be meaningful, it is particularly important that the countertrade agreement be as specific as possible as to the type, quality and quantity of the countertrade goods. Clauses in the countertrade agreement addressing these issues are discussed in chapter V.

31. [24] Pricing of goods. Since the parties are often not in a position to set the price of the countertrade goods at the time the countertrade agreement is concluded, they may establish guidelines and procedures for setting the price at a later date. Such provisions help to prevent delays in the conclusion of supply contracts and provide pricing flexibility in long-term countertrade transactions. Issues relating to pricing clauses are addressed in chapter VI.

[25] *

32. [26] Participation of third parties [change of heading]. The parties may wish to involve third parties, either as suppliers or purchasers, or both, of countertrade goods. In such cases it is advisable that the countertrade agreement contain provisions concerning participation by third parties. Those provisions could determine the manner in which a third party would be selected, whether the third party is to become bound to fulfil the countertrade commitment and the legal effect of the involvement of the third party on the obligations undertaken by the parties to the countertrade

agreement. Issues to be dealt with in the countertrade agreement relating to participation of third parties are discussed in chapter VIII.

33. [27] Payment. When payments for the shipments in each direction are kept independent, no payment issues specific to countertrade are raised. However, when the parties wish to link the payments for the shipments in the two directions so that the proceeds of the contract in one direction are used to pay for the contract in the other direction, they would have to include in the countertrade agreement provisions on the manner in which payment is to be linked. A discussion of contractual aspects of various types of linked payment mechanisms is found in chapter IX.

34. [28] Restrictions on resale of goods. The freedom of a party to resell goods purchased in a countertrade transaction may sometimes be restricted by contractual agreement between the supplier and the purchaser of the goods. The purchaser may be restricted, for example, as to the territory of resale, * resale price or packaging. Clauses in the countertrade agreement concerning such resale restrictions, as well as the question of the legality of such clauses, are discussed in chapter X.

35. [29] Liquidated damages and penalties. In order to limit disagreements as to the extent of damages resulting from a breach of the countertrade commitment, the countertrade agreement may stipulate a sum of money, specified as liquidated damages or a penalty, due from a party upon failure to fulfil the commitment to purchase or make available countertrade goods. The use of such clauses in a countertrade agreement is addressed in chapter XI. In paragraph of that chapter it is pointed out that the use of a penalty, as opposed to liquidated damages, is not permitted in a number of legal systems.

36. [30] Security for performance. The parties may use guarantees to support fulfilment of the countertrade commitment, as well as the proper performance of individual supply contracts concluded pursuant to the countertrade commitment. The use of guarantees to support the fulfilment of the countertrade commitment, or the obligation to pay under a liquidated damages or penalty clause, raises issues to be addressed in the countertrade agreement. In transactions in which the parties limit payments in cash by exchanging goods for goods or setting off countervailing payment claims, the countertrade agreement may stipulate the use of guarantees to cover liquidation of an imbalance in the flow of trade. Issues to be addressed in the countertrade agreement when the parties wish to use guarantees to support fulfilment of the countertrade commitment and liquidation of an imbalance in trade are discussed in chapter XII.

37. [31] Failure to complete countertrade transaction. The parties may wish to deal in the countertrade agreement with various issues relating to the possibility of a failure to complete the transaction. These issues include possible release of a party from its obligations under the countertrade commitment, monetary compensation, exempting impediments and interrelationship of obligations. Provisions of this type are examined in chapter XIII.

38. [32] Choice of law. It is advisable that the parties agree upon the law to be applied to the countertrade agreement and to the supply contracts. Provisions of this nature are discussed in chapter XIV.

39. [33] Settlement of disputes. It is advisable that the parties address in the countertrade agreement the manner in which disputes are to be settled. Chapter XV examines issues to be considered in preparing dispute settlement clauses.

2. Countertrade agreement without countertrade commitment

40. [34] When the parties simultaneously conclude separate contracts for the entire supply of goods in the two directions, there is no need for a countertrade agreement containing either a countertrade commitment to conclude future contracts, or clauses on the type, quality, quantity or price of the goods, liquidated damages or penalties to be paid for failure to conclude supply contracts, or guarantees to support the countertrade commitment.

41. [35] The primary purpose of the countertrade agreement in this case would be to establish a link between the contracts in the two directions, namely, that the conclusion of a contract in one direction is conditioned upon the conclusion of a contract in the other direction. The countertrade agreement may provide that a problem in the performance of one contract would have an effect on the obligation to perform the contractual obligations in the other direction (clauses establishing a link of this type are discussed in chapter XIII). The parties may also establish a link between the contracts by structuring payment for the two contracts in such a way that the proceeds of the shipment in one direction would be used to pay for the shipment in the other direction. Linked payment mechanisms of this type are discussed in chapter IX.

42. [36] In addition, the countertrade agreement may address issues such as restrictions on the resale of countertrade goods (chapter X), participation of third persons in the countertrade transaction (chapter VIII), choice of law (chapter XIV) and settlement of disputes (chapter XV).

C. Insurance and financing considerations

[Editorial note: the whole section C is new.]

43. Criteria and procedures relevant to obtaining export credit insurance or financing are largely the same for a contract forming part of a countertrade transaction as they are for a straightforward export transaction. Therefore, the Legal Guide does not discuss comprehensively export credit insurance and financing. However, to the extent credit-insurance and financing considerations are relevant to the structure of countertrade transactions, this subsection discusses those considerations.

44. In many countries a party exporting goods, services or technology may obtain insurance against the risk that the payment claim arising from the export will not be paid. In some countries such insurance schemes are run or supported by State owned entities. In addition, many private insurance companies engage in such insurance. Insurance coverage usually starts when the exporter ships the goods. If the exporter is to manufacture goods designed specifically for the buyer, some insurers might also be prepared to cover the risk that the buyer will fail to take delivery of the goods when they are manufactured and made ready for delivery.

45. Insurable commercial risks might include the insolvency of the importer, repudiation by the importer of the contract prior to the shipment of the goods, and refusal of the importer to take delivery of the goods. Insurable non-commercial risks might include import restrictions by the State of the importer; exchange control regulations in the importer's country that prevent payment to be made or prevent use of the agreed currency; cancellation of import licence that had been properly issued; war, civil insurrection or similar conditions in the buyer's country that prevent the performance of the contract; other causes that are outside the control of the exporter and importer and that arise from events outside the exporter's country.

46. Insurance cover may be negotiated for a specific transaction or, on a broader basis, for all contracts for a certain type of merchandise concluded over a specified period of time by the exporter or by a group of exporters. The latter approach, based on turnover of goods, has the advantage of spreading the risk over a number of contracts and thereby reducing the premium.

47. Several salient principles, which are related to principles found in insurance generally, may be noted with respect to export credit insurance. One principle is that export credit insurance is a risk sharing scheme. The insurer will typically assume only a portion of the non-payment risk, while the rest of the risk must be borne by the insured exporter. The insurable portion of the risk depends on the type of risk involved and, if the insurer is a State agency, on the extent to which the State wishes to stimulate exports. Another principle is that the exporter is obligated to inform the insurer, to the best of its knowledge, of all facts that may affect the degree of the non-payment risk. A further principle is that the insured exporter must take all steps in its power to ensure that the contract for the export of goods is validly concluded and that it remains valid and enforceable.

48. Yet another principle is that, if the importer fails to pay the insured claim or if the enforceability of the claim becomes doubtful, the exporter must take all steps to minimize loss and to secure or enforce the payment claim. The insurer will typically require that it be informed of any difficulty that has arisen or is imminent regarding payment to be made under the insured contract. In addition, the insurer will usually require that it be consulted about steps to be taken to secure or enforce the payment claim and that it be entitled to approve certain steps. The readiness of the insurer to provide insurance cover and the amount of the premium will depend on the security that the importer is ready to provide in support of its payment obligation. Such security may be, for example, an irrevocable documentary letter of credit, a bill of exchange or a promissory note, with a third party guaranteeing payment of the bill or note, or an independent bank guarantee.

49. The objective of securing the insured payment claim may be achieved in a countertrade transaction by linking the insured claim to the claim arising from the supply contract in the other direction. As discussed in chapter XIII, "Failure to complete countertrade transaction", paragraph ___, in some countertrade transactions it is agreed that the exporter, if the importer fails to make payment under the export contract, is entitled to take possession and sell the goods that are to be delivered by the importer (counter-exporter) to the exporter (counter-importer). The proceeds of the sale are used to cover the exporter's outstanding claim. Since such an

arrangement may reduce the risk of non-payment under the export contract, it may be easier for the exporter to obtain insurance and financing for the export contract. When a bank has provided financing to the exporter, it may be agreed, in order to provide security to the bank for the financing provided to the exporter, that the bank itself is to obtain a security interest in the counter-export goods.

50. A further principle applicable to the export credit insurance is that the insurer must be satisfied that in the normal course of events, i.e. if the exporter meets its obligations under the export contract, the importer will have no reason to refuse to pay the amount due under the export contract. Insurers wish to avoid situations where payment under the insured contract may become dependent on an event that is extraneous to the insured contract and that may be difficult for the insurer to assess.

51. The principle referred to in the previous paragraph is relevant to the case when the insured export contract forms part of a countertrade transaction. The question may arise whether the payment obligation under the export contract depends only on the performance of the export contract or whether the importer can suspend or withhold payment because of a failure of the exporter to conclude or perform a supply contract in the other direction. A source of particular concern is the possibility that payment may be suspended or withheld even if the exporter (counter-importer) claimed that the reason for the failure to conclude or perform a counter-import contract was one for which the exporter was not responsible. For example, the exporter may refuse to conclude a counter-import contract because the quality or the price of the offered countertrade goods is not acceptable in light of what was stipulated in the countertrade agreement. The possibility of such disagreement over the responsibility for non-fulfilment of the countertrade commitment is increased when the parties to the countertrade transaction have not included in the countertrade agreement definite terms of the contract to be concluded (see chapter IV, "Countertrade commitment", paragraph 39). In a further example, the exporter may refuse to take delivery of the countertrade goods if the tendered goods do not conform to the agreed standards of quality. In order to avoid the possibility that the insured payment claim might be brought into question in such a situation, the insurer will usually require that steps be taken to make that payment claim independent from any disagreement concerning conclusion or performance of the contract in the other direction. Such independence can be established by using the separate-contract approach and by including in the countertrade agreement specific provisions indicating the independence of obligations (for a discussion on how the parties may wish to deal in the countertrade agreement with the relationship between their obligations, see chapter XIII, "Failure to complete countertrade transaction", paragraphs ___to___).

52. In the case of a barter contract, the party who is deliver goods first is subject to the risk that the other party will fail to deliver its goods in return (see above, paragraphs 6 and 7). Some private insurers and, in some cases, governmental insurance agencies may be prepared to insure that risk. The case covered by such insurance would usually be limited to the bankruptcy of the party who failed to deliver and to certain political risks such as governmental restrictions or prohibitions that prevent the fulfilment of the contract. Insurance cover may be easier to obtain if the other party provides sufficient security for its obligation to deliver goods. Such security may be provided in the form of an independent bank guarantee. Another possible

security may be an agreement giving the party who has delivered goods a right to take possession of the goods to be delivered in the other direction (see above, paragraph 49).

53. Parties often require financing in order to be able to carry out the transaction. The ability of a party to insure its credit risk is an important factor in the consideration by the financial institution whether to grant the requested financing. Financing may be in the form of a supplier credit or a buyer credit.

54. In the case of a supplier credit, the exporter delivers goods to the importer under a deferred payment arrangement and, in order to enable the exporter to enter into such an arrangement, a bank in the exporter's country provides financing to the exporter. Such financing may be, for example, in the form of a loan to the exporter or in the form of an undertaking by the bank that the bank will purchase the bills of exchange or promissory notes signed by the buyer in favour of the exporter. By purchasing the bills or notes, the bank, as the endorsee, would become the creditor of the foreign buyer. If no discounting of bills or notes takes place, the bank may require the exporter to assign the payment claim under the export contract to the bank. In addition, the bank may require the exporter to assign to it the benefits of the credit insurance policy. Such an assignment is often combined with an undertaking by the insurer to the effect that, if the buyer fails to pay under the export contract, and the failure falls within the risks covered by the insurance policy, the insurer will reimburse the bank. By becoming the beneficiary of the insurance policy, the bank is exposed to the risk that the exporter would breach the export contract and as a result the buyer would justifiedly fail to pay under the export contract. In such a case the bank would have recourse only to the exporter. The bank is also exposed to the risk that the reason for the buyer's failure constitutes a risk that is not covered by the insurance policy. In order to ameliorate the position of the bank, and in order to make it easier for exporters to obtain financing, some export credit insurers might be prepared, against a fee payable by the exporter, to issue to the bank providing financing to the exporter an unconditional guarantee supporting the bank's repayment claim against the exporter.

55. Under a buyer credit, the exporter arranges for a bank in the exporter's country to provide financing to the importer for the purchase of goods from the exporter. The bank in the exporter's country typically provides financing to a bank in the importer's country, which in turn extends financing to the importer. The bank in the exporter's country receives from the export credit insurer an undertaking whereby the insurer agrees to reimburse the bank if the buyer or its bank fail to repay the credit. Such an undertaking is issued on the application of the exporter and against payment by the exporter of an agreed premium. In case of failure by the buyer or its bank to repay the credit, the insurer who has reimbursed the bank that gave the credit has recourse to the exporter only if the exporter has failed to perform the obligations under the contract for the export of goods.